

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

SEP - 8 1997

In the Matter of:

Price Cap Performance Review for Local
Exchange Carriers

Access Charge Reform

CC Docket No. 94-1

CC Docket No. 96-262

REPLY OF GTE

GTE SERVICE CORPORATION
and its affiliated domestic telephone
and interexchange companies

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September 3, 1997

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REPLY OF GTE

GTE Service Corporation ("GTE") and its affiliated domestic local exchange and interexchange telephone companies¹ hereby submit their reply to the comments filed by various parties in the above-captioned proceeding.² The record demonstrates that the adjustments to the price cap productivity factor sought by the Ad Hoc Telecommunications Users Committee ("Ad Hoc") and the AT&T Corp. ("AT&T") are

¹ GTE's affiliated domestic local exchange and interexchange telephone companies include: GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., Contel of the South, Inc., and GTE Card Services Incorporated d/b/a GTE Long Distance.

² *Fourth Report and Order* in CC Docket No. 94-1 and *Second Report and Order* in CC Docket No. 96-262, released May 21, 1997, FCC 97-159 ("Order" or "X-factor Order"). The summary of the Order was published in the Federal Register on June 11, 1997 (62 Fed. Reg. 31939). Notice of petitions for reconsideration of the Order was published in the Federal Register on August 1, 1997 (62 Fed. Reg. 41387).

unwarranted on the merits and would improperly exacerbate the already substantial and unlawful adverse impact of the new rules on price cap carriers like GTE.³

Accordingly, the Commission should deny the petitions filed by Ad Hoc and AT&T for reconsideration of the Commission's *X-factor Order*.

I. COMMENTERS CONFIRM THAT THE COMMISSION PROPERLY REJECTED THE AD HOC STUDIES AS A BASIS FOR SETTING THE X-FACTOR.

As GTE explained in its Opposition, the Commission properly rejected the Ad Hoc studies as a basis for setting the X-factor because: (1) its studies were based on proprietary software and neither the Commission nor interested parties could evaluate the methodology or documentation underlying its productivity estimate; (2) its input price index exhibits erratic fluctuations; and (3) the use of its proposed hedonic adjustment has not been justified.⁴ Notably, the commenters that addressed the issue echoed overwhelmingly GTE's conclusion that the FCC should deny Ad Hoc's request for reconsideration for the same reason it rejected Ad Hoc's studies in the *Order* – its conclusions are unreliable and not supported by record evidence.⁵

For example, Bell Atlantic explained that nothing in Ad Hoc's petition supports a reconsideration of the Commission's decision not to give Ad Hoc's productivity

³ GTE believes that it must respond to the petitions for reconsideration filed by Ad Hoc and AT&T to protect its interests in the event the FCC were to act on the petitions for reconsideration before the Court acts on GTE's petition for review.

⁴ Opposition of GTE at i, 5-7.

⁵ See, e.g., Opposition of Bell Atlantic at 7-10; Opposition of the Independent Telephone & Telecommunications Alliance ("ITTA") at 15; Opposition of the United States Telecommunications Association ("USTA") at 8-10.

submission any weight.⁶ First, many functions of the Ad Hoc model were not in the model itself, but were buried in the proprietary, commercial program relied on by Ad Hoc. In contrast, USTA and AT&T submitted their models on spreadsheet programs so that all the operations of the models were specified and any party could review the calculations. Thus, Ad Hoc's argument in its petition that the program was "advertised for sale on a regular basis in a number of well-known economic journals" is irrelevant.⁷ Second, Ad Hoc's petition failed to address the Commission's technical criticisms of its base model. Accordingly, the Commission should again reject Ad Hoc's studies as a basis for readjusting the X-factor.

II. NO SHOWING HAS BEEN MADE THAT AN HEDONIC ADJUSTMENT IS JUSTIFIED.

In its *Order*, the FCC correctly refused to apply an hedonic price adjustment to capital asset indices because such an adjustment would arbitrarily inflate the X-factor, and "neither AT&T nor Ad Hoc have shown that their hedonic adjustments accurately measure the effects of technological improvements."⁸ The commenters overwhelmingly agreed with GTE's conclusion that both Ad Hoc and AT&T failed to provide any evidentiary support for an hedonic adjustment in their respective petitions for reconsideration.⁹ Their comments demonstrate that it would be arbitrary and

⁶ Opposition of Bell Atlantic at 7-10.

⁷ Ad Hoc Petition, Declaration of Patricia D. Kravtin, ¶ 8.

⁸ *Order*, ¶ 67.

⁹ See, e.g., Opposition of Bell Atlantic at 9-10; Opposition of ITTA at 15-16; Opposition of USTA at 10.

capricious to adopt an hedonic adjustment based on general economic theory without any reliable showing that the proposed factor would accurately predict, based on verifiable factors, the effect of relevant technological improvements in this particular context.

III. MOST COMMENTERS AGREE THAT THE FCC WAS CORRECT TO REJECT ARGUMENTS THAT PRODUCTIVITY ESTIMATES FROM ONLY INTERSTATE OPERATIONS BE USED TO SET THE X-FACTOR.

The FCC has repeatedly declined to set the X-factor based on interstate-only data rather than total company data, finding in the *X-factor Order* that “the record before us does not allow us to quantify the extent, if any, to which interstate productivity growth may differ significantly from total company productivity growth.”¹⁰ GTE has already pointed out that, in their petitions, Ad Hoc and AT&T merely repeated the same arguments that the Commission has considered and correctly rejected on two occasions.¹¹ The overwhelming majority of commenters agreed with GTE that no grounds have been offered for revisiting this issue yet again.¹²

The only party to support AT&T’s petition, the American Petroleum Institute (“API”), provided no justification for basing the X-factor on interstate-only data and presented no new arguments, asserting simply that the record provides ample support for granting AT&T’s petition.¹³ In contrast, Sprint provided an additional reason for

¹⁰ *Order*, ¶ 110.

¹¹ See Opposition of GTE at 10-12.

¹² See, e.g., Opposition of Bell Atlantic at 2-4; Opposition of ITTA at 15-17; Opposition of Sprint at 2-5; Opposition of USTA at 1-6; Opposition of US West at 1-2.

¹³ Reply of the American Petroleum Institute (“API”) at 2-3.

refusing to base the X-factor on interstate-only revenues: Sprint anticipates that there will be a dramatic decrease in the per-minute-of-use-derived revenues, which will significantly slow LEC interstate productivity growth.¹⁴ In light of the lack of record support for basing the X-factor on interstate-only data, the Commission should refuse to make such an arbitrary and artificial distinction and deny AT&T's petition.

IV. THE OVERWHELMING MAJORITY OF COMMENTERS SUPPORT RETENTION OF THE LOW-END ADJUSTMENT FACTOR.

As GTE has explained, the Commission retained the low-end adjustment mechanism in order to guard individual LECs against the revised X-factor producing "unreasonably low rates."¹⁵ Apart from API, every commenter addressing the issue agreed that the Commission should neither eliminate the low-end adjustment mechanism nor reconsider its decision to eliminate sharing.¹⁶ API was the only party that supported AT&T's petition, claiming that "[i]f the Commission chooses to retain a low-end adjustment for price cap LECs experiencing deficient rate-of-return levels, then principles of regulatory parity demand that it should reinstate sharing obligations on those price cap LECs that are earning at rate-of-return levels that are too high."¹⁷ However, because the purposes of the low-end adjustment and sharing mechanisms are unrelated, the Commission's decision to retain the former does not affect its

¹⁴ Opposition of Sprint at 3-5.

¹⁵ Order, ¶¶ 11, 160. See also Opposition of GTE at 13-14.

¹⁶ See, e.g., Opposition of Bell Atlantic at 5-6; Opposition of ITTA at 17-18; Opposition of Southern New England Telephone Company ("SNET") at 1-3; Opposition of USTA at 1-6; Opposition of US West at 5-6.

¹⁷ Reply of API at 4.

decision to abolish the latter. Accordingly, the Commission should deny AT&T's petition for reconsideration of this issue.

V. COMMENTERS ARE NEARLY UNANIMOUS IN AGREEING THAT THE COMMISSION SHOULD NOT APPLY THE REVISED X-FACTOR TO THE 1995 TARIFF FILINGS.

GTE argued in its Opposition that AT&T's petition should be denied both because it offers no arguments not previously considered by the FCC and because it would exacerbate the already unlawful adverse impact of the 1996 reinitialization.¹⁸ Again, the record overwhelmingly supports with GTE's conclusion.¹⁹ For example, US West explained that, in the instant proceeding, the Commission relied on an entirely new study to establish the X-factor and that such a material change in the circumstances of regulation presents a much less compelling argument for "correcting" the prior years' PCIs than the rationale presented in 1995.²⁰ Sprint likewise supported the FCC's decision not to apply the revised X-factor to the 1995 tariff filings, emphasizing both the interim notice and the long period of uncertainty that had occurred as a result of the Commission's delay.²¹

In contrast, API's claim that the determination not to apply the revised X-factor to 1995 tariff filings penalizes consumers for regulatory delay and effectively rewards LEC

¹⁸ Opposition of GTE at 14-18.

¹⁹ See, e.g., Opposition of Bell Atlantic at 6-7; Opposition of ITTA at 18-20; Opposition of SNET at 4-5; Opposition of Sprint at 5-6; Opposition of USTA at 8; Opposition of US West at 3-5.

²⁰ Opposition of US West at 3-5.

²¹ Opposition of Sprint at 5-6.

tactics that prolong the process is baseless.²² API fails to acknowledge that the Commission – not the price cap LECs – was responsible for setting the X-factor and that retroactively reinitializing X-factors undermines price cap regulation, as recognized by the agency. This, in turn, will ultimately harm consumers more than refusing to apply the new X-factor to the 1995 tariff filings. Accordingly, the Commission should deny AT&T's request, because to grant it would constitute unlawful retroactive ratemaking and would unfairly burden LECs subject to sharing. At a minimum, the FCC should not require retroactive application of the Consumer Productivity Dividend because it cannot change LEC incentives for past behavior.

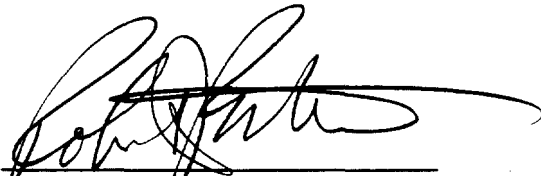
²² Reply of API at 4.

VI. CONCLUSION

For all of the foregoing reasons, as well as those set out by the Commission in the *X-Factor Order*, the petitions for reconsideration filed by AT&T and Ad Hoc should be denied.

Respectfully submitted,

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and its affiliated domestic telephone
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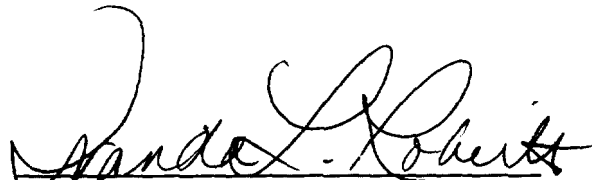
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